

Economic & Geo-Political Challenges for Small Economies

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7 November 2025

International Istanbul Economics Research Conference:

*Economy & Security: Rethinking Global Stability at the
Crossroads of Economic Policy & Security*

Istanbul University, 06/11-08/11/2025

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Small Economies – An Historical Perspective

Until the 1970/80s, most policy-makers and academics focused on the 'viability' of smaller independent territories.

- Major UK political parties (1955/56) advocated independence via conglomeration – hence the (failed) West Indies and Malay Federations.
- Diseconomies of small scale mean that jurisdictions <10m cannot survive (Kuznets, 1960).
- High per capita costs of government requires higher tax rates, reducing efficiency, investment, incomes and growth (Cameron, 1987).
- Small economies have inefficient governments and greater risk of conflict (Alesina & Spolaore, 1996; Alesina & Wacziarg, 1998).

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Small Economies – An Historical Perspective

- Little or no actual evidence to support the viability proposition – thus delaying/postponing decolonisation of smaller territories
- Serious conceptual economic analysis derive from key text (Robinson ed., 1960), in spite of mis-specifying the minimum size threshold as 10m.
- Mainstream Economics and International Relations still treat large countries 8-25m+ as small!! – that is in the 2nd size quartile or higher (see Table 1).
- Globalisation has provided ideal conditions for growth of small economies – trade/capital liberalisation – via specialisation and comparative advantage (see Table 2).

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Table 1: Size Classification of Economies by Population Quartiles, 2021

	Largest	Population (m)	Smallest	Population (m)	n
Top quartile	China	1,412.4	Cameroun	27.2	52
(Turkiye		85.0)			
2 nd quartile	Cote 'Ivoire	27.1	Bulgaria	6.9	53
3 rd quartile	Serbia	6.8	Eswatini	1.2	53
Bottom quartile	Djibouti	1.0	Nauru	0.01	52

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Table 2: Income Classification of Economies by Size, 2021

World Bank Income Group	Total n	Total (%)	Large n	Large %	2 nd Q n	2 nd Q %	3 rd Q n	3 rd Q %	Small n	Small %
<i>High</i>	75	35.7	12	23.1	15	28.3	21	39.6	27	51.9
<i>Upper-Middle</i>	57	27.1	14	26.9	11	20.8	18	34.0	14	26.9
<i>Lower-Middle</i>	54	25.7	18	34.6	16	30.2	9	17.0	11	21.2
<i>Low</i>	24	11.4	8	15.4	11	20.8	5	9.5	0	0.0
<i>Total</i>	210	100.0	52	24.8	53	25.2	53	25.2	52	24.8

Source: Calculated from World Bank (2022)

Small Economies – Takeaways from Growth Performance, 1960-2020

- Small economies are over-represented in the World Bank's High Income category – 51.7% (27 entities) and 78.8% in the top two (41 entities).
- Small economies have no representation in the Low Income category!
- This table has been stable over the last 25-30 years in spite of the global financial crisis, the Covid-19 pandemic and increasingly severe weather.
- Small economies also perform better in HDI, governance and wellbeing scores (Read, 2018). They have however, been out-performed by non-sovereign entities (Armstrong & Read, 2000, 2021)!
- [It is very evident that larger economies have therefore consistently under-performed!]

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Small Economies – Reflection, 1960-2020

Exogenous (External)

- The globalisation process, notably progress towards free trade since 1960, provided fertile conditions for growth in small economies, given their critical dependence on global economic conditions.
- The UN, WTO and *Pax Americana* provided (limited) guarantees of global political stability and adherence to international agreements.

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Small Economies – Reflection, 1960-2020

Endogenous (Internal)

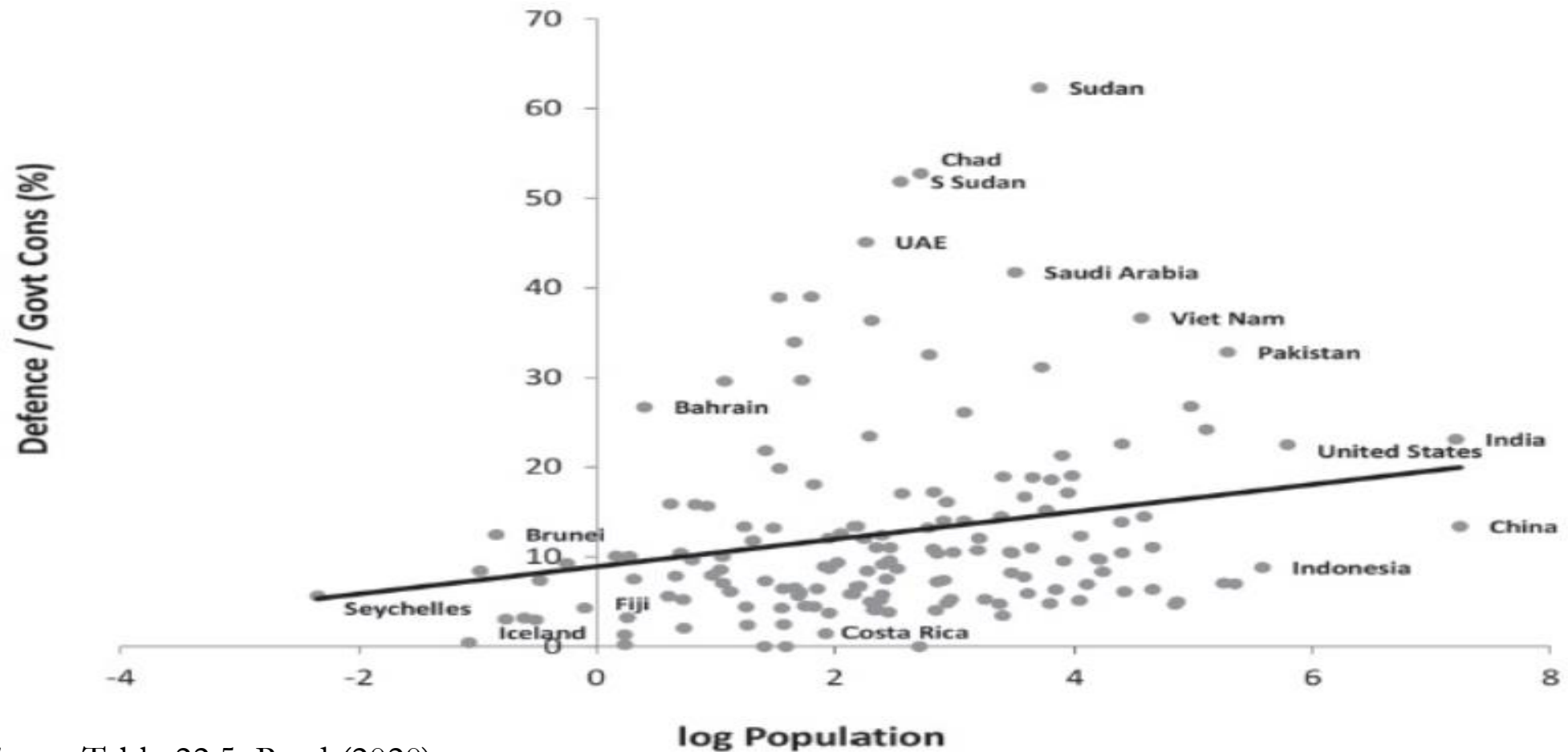
- Growth success via export-led growth based upon comparative advantage – notably human capital (education and skills acquisition) (Armstrong *et al.* 1998; Armstrong & Read, 1998).
- Specialisation in offshore finance, including tax havens, and tourism plus some natural resources (agriculture and fisheries) and manufacturing.
- Strong growth has delivered high standards of living and social support.
- They have demonstrated high levels of policy flexibility in response to rapidly changing external conditions and have nurtured bilateral diplomacy with key trading partners/former colonial metropolises.

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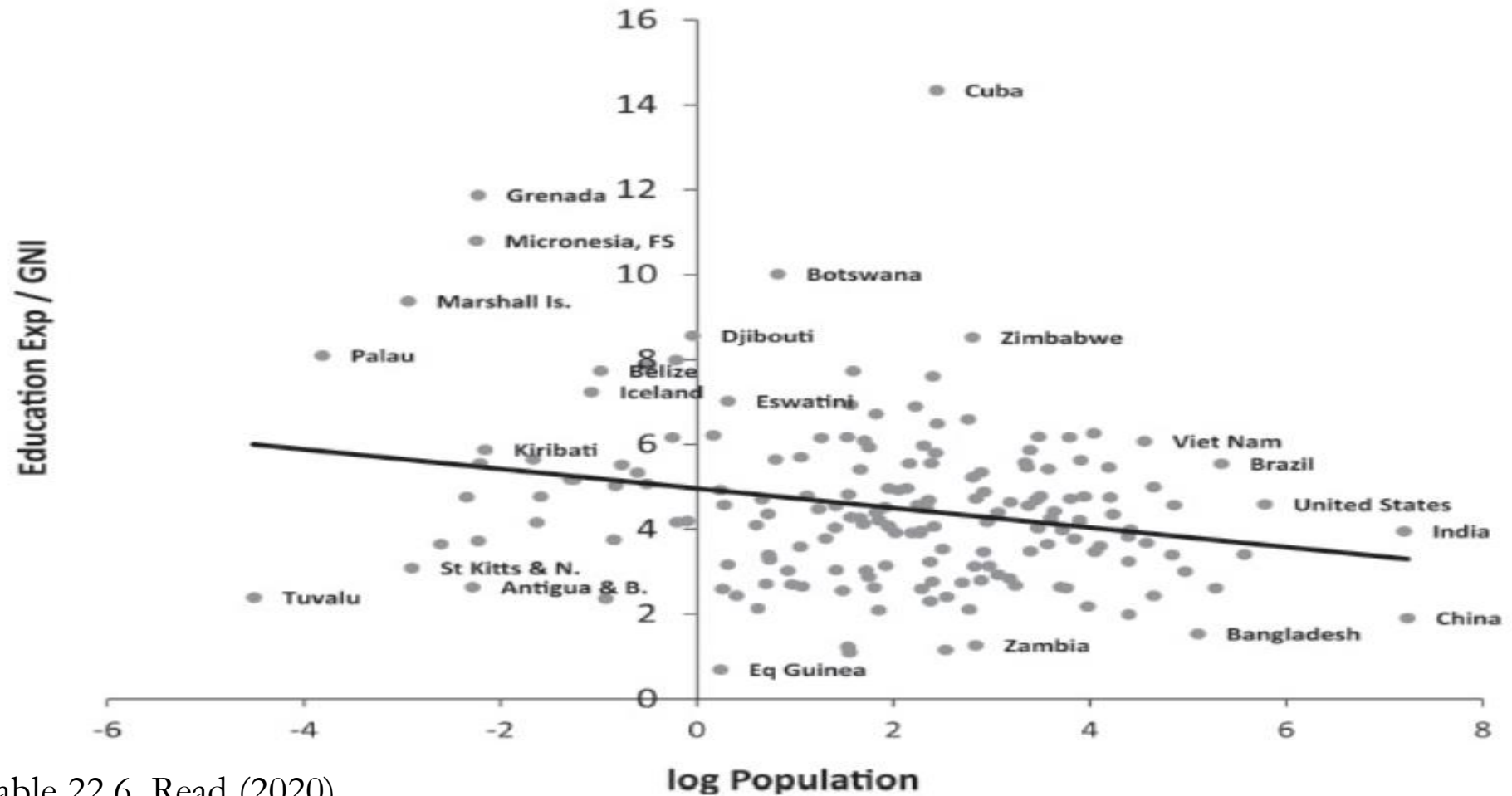
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Small Economies – Defence Share in Government Exp, 2015-17



Source: Table 22.5, Read (2020).

Small Economies – Education Share in GNI, 2015-17



Source: Table 22.6, Read (2020).

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Table 3: Global Financial Crisis: Worst Affected Small Economies, 2007-11

	2009	2011	GDP Impact (%)
N Mariana Is (US)	73.3	68.6	-31.4
Iceland	61.0	70.6	-29.4
Antigua & Barbuda	88.0	79.5	-20.5
Bermuda	92.6	86.9	-13.1
US Virgin Islands (US)	94.5	87.3	-12.7
Aruba (NL)	89.9	90.4	-9.6
American Samoa (US)	93.3	93.6	-6.4
High Income	95.8	99.5	-0.5
Upper Middle Income	107.6	122.7	+22.7
Lower Middle Income	105.5	113.7	+13.7
Low Income	102.9	104.1	+4.1
World	98.2	103.5	+3.5

Table 4: COVID-19: Worst Affected Small Economies, 2019-20

	2019	2020	GDP Impact (%)
Macau (China)	167.7	76.6	-54.3
Maldives	189.5	127.2	-32.9
Northern Mariana Is (US)	87.4	61.5	-29.6
Turks & Caicos (UK)	140.9	103.2	-26.8
St Lucia	115.8	87.6	-24.4
Aruba (NL)	101.5	77.1	-24.0
Bahamas	102.4	78.3	-23.5
High Income	111.4	106.3	-4.6
Upper Middle Income	168.7	166.7	-1.1
Lower Middle Income	147.4	140.8	-4.5
Low Income	97.0	94.4	-2.7
World	119.1	114.3	-4.0

Table 5: Global Financial Crisis/COVID-19 Combined, 2007-2022

	2007	2022	GDP Impact (%)
US Virgin Islands (US)	100.0	72.9	-27.1
Macau	100.0	74.3	-25.7
Bermuda	100.0	80.9	-19.1
Curacao (NL)	100.0	86.2	-13.8
Puerto Rico (US)	100.0	86.3	-13.7
Equatorial Guinea	100.0	92.0	-8.0
Trinidad & Tobago	100.0	93.6	-6.4
High Income	100.0	115.1	+15.1
Upper Middle Income	100.0	183.7	+83.7
Lower Middle Income	100.0	153.6	+53.6
Low Income	100.0	94.2	-5.8
World	100.0	123.1	+23.1

Small Economies – Insights from the Global Financial Crisis & COVID-19 Pandemic?

The Global Financial Crisis: spread via exogenous financial and economic shocks from leading industrialised economies. Small size and distinct patterns of specialisation (financial services and tourism) amplified the adverse impacts of the crisis relative to larger economies and delayed recovery (Armstrong & Read, 2020).

The COVID-19 Pandemic: economic effects spread primarily via the collapse of global tourism, affected small economies particularly adversely – health services, furlough costs, unemployment, rising fiscal deficits and debt.

Combined Crisis Effects: Greater exposure, over-specialisation and less capacity to cope; several had lower incomes in 2022 than 2007 – including Northern Marianas (61.5%), US Virgin Is (72.8%), Bermuda (80.9%), Palau (82.1%), Curacao (86.2%) (Armstrong & Read, 2025).

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Small Economies – The Coming Storms

Small economies face major economic, political, social and environmental challenges. These are mostly exogenous but require endogenous policy responses to attempt to mitigate their internal impacts.

International financial regulation: EU/IMF continue to clamp down on offshore finance centres, particularly tax havens, to limit money laundering and improve tax transparency. This threatens incomes, growth and employment in the wealthiest small economies, including territories.

Medium- & long-haul tourism: The very high degree of dependence of many small economies, especially small islands, upon long-haul tourism is unsustainable given climate action, carbon emission taxes. This represents a critical threat to incomes, growth and employment.

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Small Economies – The Coming Storms

Global political economy retrenchment: Inward-looking nationalist retrenchment (e.g., in the US) is leading to global 'Balkanisation' and challenges to the post-war international regulatory superstructure. The post-war *Pax Americana*, is (temporarily?) at an end and the UN, WTO and other global institutions (e.g., UNESCO) are being weakened/undermined. Increasing nationalism (and Mercantilist policies) together with assertive emerging powers (e.g., China) competing to fill the vacuum left by the US retreat are leading to a reconfiguration of global relationships. Small economies are highly exposed to increasing risks of strategic encroachment and conflict.

Global heating/climate change: small economies are negligible contributors to climate change but highly exposed to its effects – rising sea-levels, loss of low-lying territory, fresh water lenses and bio-diversity as well as greater susceptibility to increasingly severe weather events.

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Small Economies – Sheltering from the Coming Storms?

Economic solutions: diversification has long been advocated but the range of feasible options is very limited owing to their characteristics (the IMF and World Bank continue to push tourism!). Reliance upon the *Blue Economy* appears mis-placed – apart from solar/wind energy generation; tourism (!), fisheries and deep-sea mining all have adverse environmental effects.

Global political economy solutions: global (temporary?) retrenchment requiring closer alignment/integration with major powers, reduced sovereignty and increased defence expenditure.

Climate change solutions: requires a global focus on reducing carbon emissions, switching to renewable energy sources and reduced air travel.

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